

Northern Trust | Investors Leading the Fed

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The Federal Reserve reduced interest rates by 25 basis points last week and we think there are more reductions in US interest rates to come. Let's look at what happened and what it means for investors.

Moderate US economic growth, inflation stuck at low levels, easy central banks across the globe, and lower interest rates virtually everywhere else, made the Fed's job simple in reducing the Fed Funds Rate by 25 basis points last week. The key points to be addressed are the fact that the Fed moved 25 instead of 50 basis points, and what does this mean for future monetary policy in the US?

The reduction by just 25 basis points wasn't a surprise. Investors had set the Fed up for this, although there were calls in some corners for the Fed to go ahead and reduce rates by 50 basis points right away. One of the problems the Fed had with regard to a 50 basis point move was the likely understanding by Fed members that investors would go ahead and price in more interest rate reductions whether the Fed move 25 or 50 basis points anyway. So less was more for the Fed.

This is a real credibility issue for the Fed. Investors are controlling the narrative and the likely course of interest rate moves and timing. The Fed has very little control, and that was even more evident during the post-decision press conference when Chairman Jerome Powell was inconsistent and confusing. He continued to instill very little confidence in investors.

While the Fed appears cautious with respect to further rate decreases, investors are not. And the investors in the market have had a much better forecasting history than the Fed. It's been over a decade since the Fed last reduced interest rates, and this is the beginning of another cycle of easing. We see at least two, and likely three more rate reductions of 25 basis points before the end of the year, and another one in 2020, which represents a good environment for risk taking.

We believe economic growth is going to be lower for longer, inflation is going to be lower for longer, and interest rates are going to follow the same path. We think rates are headed down, and the only thing the Fed can do is come along for the ride.

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